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INFO RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE
RUEHUJA/AMEMBASSY ABUJA 2187
RUEHAR/AMEMBASSY ACCRA 2607
RUEHDS/AMEMBASSY ADDIS ABABA 2729
RUEHBY/AMEMBASSY CANBERRA 1998
RUEHDK/AMEMBASSY DAKAR 2354
RUEHKM/AMEMBASSY KAMPALA 2778
RUEHNR/AMEMBASSY NAIROBI 5206
RUEAIIA/CIA WASHDC
RUEHGV/USMISSION GENEVA 1899
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC
RUZEJAA/JAC MOLESWORTH RAF MOLESWORTH UK
RUZEHAA/CDR USEUCOM INTEL VAIHINGEN GE

UNCLAS SECTION 01 OF 04 HARARE 000096

SENSITIVE
SIPDIS

AF/S FOR B. WALCH
AF/EPS FOR ANN BREITER
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR D. PETERS
COMMERCE FOR ROBERT TELCHIN
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: N/A
TAGS: ECON EFIN EAGR EMIN PGOV ZI
SUBJECT: ZIMBABWE,S LATEST MONETARY POLICY EMBRACES MARKET
LIBERALIZATION

REF: A. HARARE 091
¶B. HARARE 077
¶C. HARARE 061

SUMMARY

¶1. (SBU) Reserve Bank Governor Gideon Gono announced the liberalization of the foreign exchange market in his Monetary Policy Statement on February 3, 2009. He dropped another 12 zeros from the local currency, which will co-circulate alongside hard currencies and be exchangeable at the market-determined interbank rate. He announced the freeing of most prices, steep foreign exchange license fees for shops and businesses trading in hard currencies, a lower surrender requirement for foreign exchange earnings, and lower statutory reserve requirements for banks. Gold will now be traded more freely and there is a plan to repay arrears to gold producers. On the other hand, and boding ill for market liberalization and respect for property rights, he revoked formal contractual agreements with international platinum and diamond mining companies that allow them to retain earnings offshore. The GOZ's external and domestic debt is onerous and impossible to service with Zimbabwe's fiscal and monetary policies. The decision to leave the Zimbabwe dollar in circulation is futile in light of the public's loss of confidence in the currency. Worryingly, it also leaves the door open for Gono to revert to off-budget spending. Without substantial balance of payments support, Zimbabwe's reforms will not succeed. This is a compelling reason for us to continue to press for Zimbabwe to engage the international community on economic policy, and on the community's terms.

END SUMMARY.

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Foreign Exchange Liberalization; More Zeros Dropped
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¶2. (U) Following Acting Finance Minister Chinamasa's Budget Statement on January 29 (Ref. B), Gono reiterated in his monetary Policy Statement (MPS) on February 3 that hard currencies may now be used in all transactions, and that the local currency will remain in circulation at the same time "to safeguard... national identity and sovereignty." Addressing the recurrent logistical problems of transacting in trillions and quadrillions, he lopped a further twelve zeros off the Zimbabwe dollar, bringing to 25 the number of zeros removed in the last 2 1/2 years. High-denomination Zimbabwe dollar notes will stay in circulation alongside new notes until June 30, 2009. (NOTE: The 10 and 20 trillion Zimbabwe dollar notes are in the market, but the announced 50 and 100 trillion dollar notes have not yet entered circulation. END NOTE.)

¶3. (U) The exchange rate will now be market-determined with the starting interbank rate set at Z$2 (re-valued) to the Qthe starting interbank rate set at Z$2 (re-valued) to the South African Rand and Z$20 (revalued) to the U.S. dollar. Shops are required to post prices in both hard currency and in Zimbabwe dollars. (COMMENT: Since the Statement, the interbank exchange rate has depreciated every day while the street value of cash has fallen evenfaster, indicating that the former is already out of sync with the market, as it was

throughout 2008. END COMMENT.)

Liberalized Prices and Trading

¶4. (SBU) Gono reiterated the liberalization of prices. He also broadened the licensing of shops selling goods and services in foreign currency to cover the whole country. All of Zimbabwe, in fact, is now a designated Special Export Processing Zone. Businesses trading in hard currencies are required to register with the RBZ and pay a license fee in 12 monthly installments. They are also required to sell 5 percent of their foreign exchange receipts to the RBZ at the day's interbank exchange rate. The license fee ranges from US$12,000/year per outlet in urban zones, to US$6,000 in peri-urban zones, US$4,000 in towns and US$1,200 in rural areas. (COMMENT: Although Chinamasa stated that registration was for tax purposes, and we had understood there would be no registration fee (Refs. B and C), the Governor appears intent to use license fees to raise foreign exchange. END COMMENT.) Foreign exchange generating companies are now allowed to pay employees in foreign currency without seeking RBZ Exchange Control approval. Salaries have to be paid into Foreign Currency Accounts (FCAs).

¶5. (SBU) Gono reduced FCA surrender requirements from 15 percent to 7.5 percent and allowed the retained amounts to be held in the FCAs for an indefinite period, rather than 21 days. The surrender requirement also applies to agriculture, with the exception of cotton and tobacco, where growers may retain 100 percent of their foreign exchange receipts. Cash payouts to farmers will cease; they must now open FCAs for payments. Cargill Cotton MD Priscilla Mutembwa expressed concern to econoff about how growers in far flung areas of the country could possibly open FCAs by the start of the cotton buying season in eight weeks.

¶6. (U) Gono reiterated that utilities and parastatals are now allowed to charge for their services in both local and foreign currency. Corporates and those living in low-density areas including NGOs and Embassies will pay in foreign exchange while those in rural areas and high-density suburbs

will pay in local currency. Parastatal prices will cover costs.

¶7. (SBU) Trading on the Zimbabwe Stock Exchange (ZSE) will resume in foreign exchange once revaluation of the listed companies is completed. However, counters have to pay a financial stability levy of 1.5 percent to the RBZ in forex and each seller has to liquidate 3.5 percent of proceeds to the RBZ at the interbank rate. These charges will raise the cost of doing business on the ZSE and discourage trading.

Banking Sector Reform
QBanking Sector Reform

¶8. (U) Gono announced a reduction in statutory reserve requirements for commercial and merchant banks for both local and foreign deposits from 50 percent to 15 percent and 10 percent respectively. He removed restrictions on foreign currency withdrawal limits, which will put pressure on the

banking industry to source foreign exchange. Moreover, banks can now levy charges for FCA transactions in forex. Banks are also allowed to lend in forex and apply an interest rate of not more than LIBOR plus 1-6 percent, depending on risk. All current account transactions have, by and large, been liberalized with the removal of the Exchange Control priority list.

¶9. (SBU) Without addressing money laundering implications, Gono also announced that, with immediate effect, individuals and corporates shall be allowed to deposit up to US$250,000 into their FCAs, "no questions asked." Residents may also export up to US$250,000, again, "no questions asked."

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One Step Forward, Two Steps Back on Mining Policy
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¶10. (U) In a measure to increase gold production which Gono said fell from 6,798 kg in 2007 to 3,072 kg in 2008, he announced that gold producers may now retain 92.5 percent of their proceeds. Cautiously optimistic, Paul Markham, President of the Gold Producers Association, nevertheless told econoff on February 5 that "the devil is in the detail, and there is no detail." Addressing the long-seething issue of government arrears to gold miners, Gono announced conversion of the arrears into one-year "Special Tradable Gold-backed Foreign Exchange Bonds" with an interest rate of 8 percent per annum, payable by the RBZ to the holder on maturity.

¶11. (SBU) Gono repeated that diamonds, platinum and emeralds, like gold, are now classified as "strategic reserve assets." The RBZ would, with immediate effect, "license and closely oversee the financial flows in these minerals, as well as other marketing arrangements." Furthermore, and boding ill for the liberalization thrust of the Budget and Monetary Policy Statement, in one stroke Gono revoked longstanding contracts between the GOZ and diamond and platinum companies in Zimbabwe. The contracts had allowed the companies to keep their foreign exchange earnings offshore.

Off-Budget Spending; M3 Growth

¶12. (U) The MPS refers several times to the narrowing of RBZ activities to the core responsibilities of a central bank. While Acting Minister of Finance Chinamasa had said that quasi-fiscal activities have been paid off (Ref. A), confusingly, he MPS refers to streamlining the activities and handing them over to Fiscorp (Pvt) Ltd. On a related note, Gono stated that money supply growth (M3) in 2008 was

658 billion percent.

Onerous External and Domestic Debt

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¶13. (U) Gono revealed that the country's external debt was US$4.69 billion at end 2008; 76.9 percent of it owed by government, 18.4 percent by public enterprises, and 4.7 percent by the private sector. About 44 percent of the debt

is owed to multilateral creditors, 50 percent to bilateral creditors, and 6 percent to commercial creditors.

¶14. (U) Government domestic debt at end-2008 was Z$56.9 sextillion, up from Z$390.5 million in mid-August 2008. It is financed to 99.99 percent through the issuance of 365-day treasury bills, and commercial banks hold 99.9 percent of the debt. Gono pointed out the refinancing risk associated with the need to roll over the debt portfolio annually.

COMMENT

¶15. (SBU) While the Monetary Policy Statement by and large points in the right direction by accepting the superiority of markets over government controls, the RBZ interference in diamond, platinum and emerald mining is worrying. Zimbabwe's formal platinum and diamond mining agreements are unique. As production of all other minerals collapsed under tight RBZ control, the agreements gave comfort to investors in these minerals. The most egregious and troubling contradiction in the past week's economic policy announcements is the pledge on the one hand to respect market forces and property rights and to return the RBZ to its core responsibilities, while on the other hand introducing controls in the very sector that will be key to generating the foreign exchange needed to fund Zimbabwe's long term recovery. This is important because Gono, like Chinamasa in the budget statement, fails to address how monetary policy will help bridge the yawning gap between realistic tax revenue projections and the immense and immediate pressure to expend unavailable foreign exchange.

¶16. (SBU) The decision to leave the Zimbabwe dollar co-circulating with hard currencies is a futile exercise in light of the transacting public's loss of faith in the unit. Yet Gono apparently wants to retain some leverage to be able to revert to printing to fund off-budget spending in the face of a tight foreign exchange constraint. Without substantial balance of payments support, Zimbabwe's reforms will not succeed. This is a compelling reason for us to continue to press for Zimbabwe to engage the international community on economic policy, and on the community's terms.

¶17. (SBU) The budget and monetary policy statement may have Short shelf-lives. Tsvangirai and the MDC have been harshly Critical of the budget and Gono; at an OECD briefing on February 5 (Ref A), Tsvangirai said the incoming MDC Minister of Finance would formulate a new three-month budget. Tsvangirai also said one of his first orders of business would be to remove Gono. END COMMENT.

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